



The **Community Builders, Inc.**

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**VIA FACSIMILE (202-622-8244)
AND FIRST CLASS MAIL**

Acting Director
Community Development Financial Institutions Fund
U.S. Department of the Treasury
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To Whom It May Concern:

Attached are comments prepared by The Community Builders, Inc. in response to the Advanced Notice of Proposed Rulemaking (FR 21844) and Guidance (FR 21846) concerning the New Markets Tax Credit. The comments address, among other things, selected "Pending Issues" set forth in Section VII of the Guidance.

Sincerely,

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On May 1, 2001, the Department of Treasury, Internal Revenue Service (the "IRS") published an Advance Notice of Proposed Rulemaking (ANPR) (FR 21844) concerning the New Markets Tax Credit (NMTC) program. The ANPR invited public comment on specific issues and any other issues for which taxpayers feel guidance is necessary. Simultaneously with the issuance of the ANPR, the Community Development Financial Institutions Fund (the "Fund") issued Guidance concerning the NMTC program. The Community Builders, Inc. offers the following comments on certain NMTC issues, including selected issues highlighted in the ANPR and "Pending Issues" identified in Section VII of the Guidance, as well as issues not specifically addressed in the ANPR.

I. About Community Builders

Community Builders is a 501(c)(3) organization anticipating formation of a subsidiary corporation that will apply for designation as a Qualified Community Development Entity (CDE) and allocation of New Markets Tax Credits.

Community Builders is the largest urban nonprofit housing developer in the country. Over the past 37 years, Community Builders has completed more than 16,000 housing units in over 190 projects, developed 400,000 square feet of commercial/retail space, and raised in excess of \$1.2 billion in project financing. Our corporate competencies include neighborhood planning, real estate development, equity syndication, debt financing, property management, and family self-sufficiency services for residents. Our Finance Division is expert in forming, managing, and reporting on complex real estate partnerships, structuring over 100 partnerships involving syndication of Low Income Housing Tax Credits, Historic Rehab Tax Credits, and other tax benefits. Our development activities, taking place predominantly in Low-Income Communities (as that term is used in the proposed regulations), include rental and for-sale housing development, commercial/retail development, and development of community centers, schools, and other community facilities. We provide property management services at 60 affordable housing developments containing over 5,200 units. We also coordinate supportive services and economic self-sufficiency programming and community building at 28 housing sites.

Community Builders specializes in large-scale neighborhood revitalization efforts anchored by redevelopment of distressed public and assisted housing. Ranging from 150 to 1,100 units in size, these developments constitute major blighting influences that inhibit private investment. Demolition and redevelopment of these properties can reposition a neighborhood, unlocking its potential to attract new investment. The scale of these undertakings not only rejuvenates real estate and commercial/retail markets in

distressed neighborhoods, but also presents unique opportunities to create pathways to employment and home ownership for low-income families within the context of a richly supported, mixed-income community.

Community Builders has thirteen regional offices in the Northeast, Mid-Atlantic, and Midwest. We are engaged in eleven HUD HOPE VI public housing transformation projects and several redevelopment projects involving large distressed HUD-assisted properties. Our current pipeline consists of 81 development projects containing over 6,000 units in 31 cities, all scheduled for completion by 2007. Our corporate infrastructure and committed development pipeline position us to utilize New Markets Tax Credits to stimulate investment in new private capital that will facilitate economic and community development in distressed communities.

II. Proposal for Specific Uses of New Markets Tax Credits

A. Proposed Uses: Community Builders envisions three ways in which large non-profit sponsors could use the NMTC program to advance comprehensive neighborhood revitalization goals.

1. Capitalization of Development Financing Vehicles

Large-scale revitalization projects that address housing, retail/commercial, infrastructure, and community facilities require substantial amounts of capital. While a variety of sources are available to stimulate housing development, it is often extremely difficult to generate investment in retail/commercial, infrastructure and community facilities in Low-Income Communities. The NMTC program can help provide much-needed capital for community revitalization activities sponsored by mission-oriented nonprofit organizations such as Community Builders. We envision non-profit sponsors with substantial development pipelines creating for-profit subsidiaries (qualified CDEs) to raise capital from private investors for the purpose of investing in Qualified Low-Income Community Businesses that provide development financing for a broad range of neighborhood revitalization activities. This financing would include predevelopment loans, bridge loans, construction and permanent loans, and equity. Revenues from development financing activities, coupled with NMTC benefits, could provide investors a competitive rate of return while stimulating redevelopment of Low Income Communities.

2. Capitalization of Property Management Companies.

Effective property management services are critical to the recovery and long-term stability of Low-Income Communities. The presence of high quality property management directly affects a neighborhood's ability to attract ongoing private investment to support community and economic development. High quality property management is especially important in mixed-income housing developments, such as those being created through HUD's HOPE VI public housing transformation efforts. In these settings the ability to provide a level of services that can attract and retain market-rate renters to live alongside public housing and working poor residents is vital to both

the long-term viability of the development and the achievement of larger neighborhood revitalization goals.

Property management activities have the potential to generate sufficient earnings to attract private investment. However, where rents are reduced to preserve affordability (for example, in privatized public housing developments), or where property managers provide enhanced supportive services (such as care for frail elders or self-sufficiency programming for families entering the job market), property management revenues are typically insufficient to attract private investment. In this situation, the NMTC could enhance potential returns to investors, enabling well-capitalized property managers acting on behalf of non-profit sponsors to sustain a long-term mission-oriented involvement in Low-Income Communities. A for-profit subsidiary corporation formed to conduct property management activities could seek designation as a qualified CDE, and provide private equity investors a competitive return from a combination of property management revenues (generated from Low-Income Communities) and NMTC benefits. Through such capitalization, the management entity would be able to improve the investment climate in Low-Income Communities, while providing services necessary to support resident self-sufficiency programming.

3. Commercial Real Estate Development and Commercial Activity as part of Neighborhood Revitalization Programs.

Large-scale neighborhood transformation projects, anchored by revitalized public or assisted housing developments, must include commercial/retail development to succeed in attracting and retaining residents with a broad mix of incomes. Often, the presence of a formerly distressed public or assisted housing development has adversely impacted commercial/retail activity as well as the surrounding residential areas, requiring an investment of capital to restore the appearance and vitality of the commercial/retail sector. An NMTC allocation to specific commercial projects, or to a non-profit sponsored entity that finances such projects, could generate a return capable of attracting private investment notwithstanding the perceived risks inherent in commercial development in low income communities. For example, in the Lincoln Court HOPE VI revitalization project in Cincinnati, Ohio, The Community Builders is the sponsor of a mixed use development that will include family rental housing, elderly rental housing and commercial space. This is part of the first phase of a multi-phase comprehensive neighborhood revitalization effort at Lincoln Court, including multi-family rental development, home ownership, and commercial development. We are engaged in a similar comprehensive revitalization program at the former Laurel Homes public housing development, also in Cincinnati. Addressing only the residential needs of that community would overlook the compelling need to stimulate the commercial sector as a critical piece of a comprehensive revitalization effort.

Similar mixed-use development is becoming an increasingly important part of neighborhood revitalization efforts. We are sponsoring development including significant commercial space in Coatesville, Pennsylvania and New Brunswick, New Jersey. In each of these developments (Lincoln Court, Laurel Homes, the Downtown

Revival project in Coatesville, and in New Brunswick), we anticipate that both the development of the commercial space and the proposed commercial activity (whether office space, retail or light manufacturing) ultimately will generate a reasonable return. However, attracting the equity investment needed to capitalize such activities in Low-Income Communities can be challenging. The redevelopment of these communities would be assisted enormously by allocation of New Markets Tax Credits.

4. Capitalization from other CDEs.

Each of the three uses above, with CDE status, could receive loans and or equity investments from other CDEs to advance stated purposes.

B. Regulatory Issues Affecting Potential Uses of New Markets Tax Credits

With these uses in mind, we offer the following comments to inform further development of regulations to govern the NMTC program:

1. Definition of a Qualifying Community Development Entity (CDE)

The Guidance states that a CDE must have a primary mission of serving or providing investment capital for Low-Income Communities or Low-Income Persons; that the entity must retain accountability to residents of Low-Income Communities; and that the entity must be certified by the Fund as a CDE. To avoid the need to establish multiple CDEs in various geographic locations, regulations should specify that a CDE serving multiple communities can satisfy the low-income resident accountability requirement by forming local advisory councils with representation from residents of Low-Income Communities, which in turn make recommendations to a regional or national level CDE.

In addition, we would urge that the regulations recognize and encourage participation by non-profit sponsors with a demonstrated track record of involvement in and commitment to Low-Income Communities.

2. Qualifying Low Income Investment

The Guidance defines Qualifying Low-Income Community Investment (Qualifying Investment) as, among other things, “any capital or equity investment in, or loan to, any Qualified Active Low Income Community Business.” To facilitate rapid investment in multiple communities through a national CDE, we would urge that regulations retain broad latitude for investments in multiple qualifying Low-Income Communities.

3. Definition of Qualified Active Low Income Community Business

The Guidance defines Qualified Active Low Income Community Business (Qualified Business), noting that the “rental to others of residential property (as defined in IRC Section 168(e)(2)(A)) is not a Qualified Business.” We would urge that regulations clarify that development financing and property management are business functions

distinct from the rental of residential property, and outside the exclusion pertaining to rental of residential property.

4. Definition of Financial Counseling and Other Services

The Guidance defines Qualifying Low Income Community Investment to include “financial counseling and other services”. A series of services designed to stabilize families, support success in the workforce, and build personal and family assets are necessary to increase levels of homeownership and create a favorable climate for private investment in Low-Income Communities. We would urge that “financial counseling and other services” be defined to include family stabilization, intensive case management, workforce development, asset building, financial literacy, homeownership preparation, and post-purchase home ownership support.

III. Selected Responses to IRS “Pending Issues” (comments follow the section numbering of the proposed regulation)

1. Section 45D(b)(1)(B).

Community Builders would urge that the “substantially all” test under 45D(b)(1)(B) be applied against the net investment after deduction of issuance costs and reserves. It would be helpful to establish safe harbor amounts for issuance costs and reserves, as well as amounts required for day-to-day operation of the CDE itself. CDEs, however, should be able to demonstrate good cause for exceeding safe harbor limits.

As with any tax-driven investment vehicle, ease of administration will be key to generating investment. If investors are able to easily monitor compliance with program requirements, they will be more inclined to invest capital in NMTC-assisted programs. For this reason, it is essential that the “substantially all” requirement be administered in such a way that investors can have confidence, based on periodic investigations, that they will not lose credits. To take an example, if repayment of a qualifying debt or equity investment would cause a CDE to violate the “substantially all” test, then the CDE should have a reasonable period of time to reinvest the money in a substitute investment. The substantially all test should be applied based on the average level of investment over a credit year, rather than on a daily basis.

The determination regarding whether a trade or business constitutes a “Qualified Low-Income Community Business” should be made at the time of the investment in the business based on reasonable expectations. Investors will be disinclined to make investments based in part on NMTC if the credit is at risk due to factors beyond the CDE’s control – for example, a change in the average income of the community, or a decision on the part of an initially Qualified Business to expand or relocate, causing it to lose its status as a Qualified Business. The only circumstances under which an investment in a Qualified Business should lose its status as a Qualifying Investment by reason of a subsequent failure of the Qualified Business to satisfy the requirements for a Qualified Business would be if the CDE exercises substantial control over the business

through stock ownership, majority representation on the board of directors, or overlapping officers.

2. Section 45D(b)(3)

It is essential that grace periods be provided, given that a CDE may fail to meet the safe harbor test under Section 45D(b)(3) at some point during the 7-year credit period due to repayment of debt or equity. The grace periods should take into account the length of time needed to find an alternative investment, complete due diligence and close.

3. Section 45D(d)(1)(C)

As noted earlier, we would urge that “financial counseling and other services” be defined to include family stabilization, intensive case management, workforce development, asset building, financial literacy, homeownership preparation, and post-purchase homeownership support.

4. Section 45(D)(f)(2)

In determining eligibility for priority for track record, we would urge that historical success in making investments be given more weight than an expressed intention to make loans and investments to third parties. In the context of the low-income housing development industry, a corporate evolution from a development organization to a multifaceted organization that includes development and financing constitutes a rational reaction to industry needs. Regulations should not penalize entities that have successfully pursued innovative internal financing strategies, particularly where an internal financing structure can deliver a substantial volume of private investment quickly and efficiently.

5. Section 45D(g)(3)(B)

The circumstances that constitute a change in use of the proceeds of a Qualifying Investment that triggers a recapture event under this section must be within the reasonable control of the CDE. Thus, for example, a CDE that intentionally makes investments that do not initially qualify as Qualifying Investments, or that fails to make investment of substantially all of the proceeds of the equity investment within the required period (absent good cause) should be subject to recapture. However, a CDE that initially made Qualifying Investments should not be subject to recapture due to subsequent failure of the investments to qualify for reasons beyond the CDE’s control. Moreover, given the potentially lower rates of business absorption in Low-Income Communities, and the heightened vulnerability of Low-Income Community businesses to economic downturns, a CDE should have the ability to take remedial actions to avoid recapture if additional time is needed to invest substantially all of the proceeds of equity investment in Qualifying Investments.

6. Section 45D(i)(1)

As noted earlier, Low-Income Communities often have a substantial need for mixed-use residential and commercial developments to stimulate neighborhood revitalization. While a strictly residential development should not be able to utilize both the low income housing tax credit under Section 42 and the New Markets Tax Credit, a mixed-use development may have need of both. It may be appropriate to separate ownership of the residential and commercial components, as in a condominium or a long-term lease structure. What would not be appropriate, however, would be to “taint” a legitimate Qualifying Investment in commercial or retail activity simply because it was being developed in conjunction with a residential development.

We are pleased to offer these comments, and look forward to being able to utilize the New Markets Tax Credit as a vehicle for stimulating revitalization of Low-Income Communities.

Sincerely,

THE COMMUNITY BUILDERS, INC.